APPENDIX B

In the

United States Court of Appeals

For The Fifth Circuit

No. 23923

UNITED STATES OF AMERICA,

Appellant,

versus

WILLIAM J. ROCHELLE, JR., Trustee in Bankruptcy for JOHN MILTON ADDISON, Bankrupt,

Appellee.

Appeal from the United States District Court for the Northern District of Texas.

(October 20, 1967.)

Before RIVES, WISDOM and GOLDBERG, Circuit Judges.

WISDOM, Circuit Judge: Is money obtained from a swindle taxable income to the swindler? We hold that it is. And it makes no difference if the swindle is in the form of a loan and the "lenders" so beguilded that they really believe that they made bona fide loans.

* * * * *

Once again the financial dealings of promoter John Milton Addison are before the federal courts.[1] The present case involves a claim for federal income taxes asserted in Addison's bankruptcy proceedings. The contest is between the taxing authorities and the trustee, representing creditors defrauded by Addison. These creditors "lent" money to Addison to finance non-existent enterprises. The basic facts are not in dispute.

Creditors filed an involuntary petition in bankruptcy against Addison on February 23, 1960, and on July 7, 1960, he was adjudicated a bankrupt. Before this adjudication, the Secretary of the Treasury, on July 2, 1959, had terminated Addison's tax year under Section 6851 of the Internal Revenue Code of 1954 (26 U.S.C. § 6581). Addison's tax liability for the period from January 1, 1959, through June 30, 1959, was assessed in the amount of $124,485.24.

On July 3, 1959, the District Director of Internal Revenue served a notice of levy with respect to this tax liability on Braniff Airways, Inc. At that time Braniff was holding Addison's brief case—left overlong in an airport locker—containing checks and money orders totaling $146,625, of which $20,925 was in personal checks payable to Addison, later found to be uncollectable, and $125,700 was in cashier's

[1] Addison and a number of his associates were convicted of violations of the Securities and Exchange Act, using the mails to defraud, and conspiracy. The transactions involved in the criminal prosecutions were in part the same so-called "loans" as are before us in this case. See *Addison v. United States*, 5 Cir. 1963, 317 F. 2d 808, cert. denied, 376 U.S. 905, 84 S. Ct. 658, 11 L. Ed. 2d 605, reh. denied, 376 U.S. 966, 84 S. Ct. 1121, 11 L. Ed. 2d 984. See also *S.E.C. v. Addison*, N.D. Tex 1961, 194 F. Supp. 709, in which Addison and his associates were enjoined from issuing "securities" to secure the "loans".

checks, bank money orders, and American Express money orders. These funds were transferred to the referee in bankruptcy under a court order providing that the transfer should be without prejudice to whatever rights the United States may have acquired by the levy.[2]

In due course of the bankruptcy proceeding, the United States filed its proof of claim for the amount of Addison's alleged tax liability. If the claim of the United States is allowed, it will take first priority and exhaust the assets of the bankrupt estate. The bankruptcy proceedings were held up to await the outcome of a criminal prosecution brought against Addison. Eventually, after a hearing in 1965, the referee in bankruptcy entered an order disallowing the claim of the government.

The trustee found: "There is no evidence that the Bankrupt in fact did in good faith intend to repay the money or interest thereon in accordance with his promises, and the inference which I draw from the evidence is that he had no such intention". Nevertheless the trustee took the view that "a broad definition should be accorded the term 'loan' "; that the "subjective intent of the borrower, undisclosed to trusting lenders, not to repay the money" does not convert a loan into taxable income; that "if the issue arose between the taxing authorities and the fraudulent borrower, con-

[2] The trustee does not contest the validity of the lien. Even if we were to accept, *arguendo*, the contention that the funds held by Addison were "loans", it is clear that they were induced by a fraudulent scheme, and therefore Addison had sufficient legal interest in money for it to be properly subject to levy. See *Akers v. Scofield*, 5 Cir. 1948, 167 F. 2d 718, *cert. denied*, 355 U.S. 823, 54 Tex. Jur. 2d, Swindling and Cheating, §§ 2, 14.

ceivably the answer might be different." The district judge, Judge T. Whitfield Davidson, agreed with the Referee: "The Court's position is that the Referee in his findings must be sustained. *That which a man borrows he does not earn.*" (Original emphasis.) We reverse.

I.

John Milton Addison was no small-time confidence man. Nor did he appeal to persons satisfied with small profits. During the tax period in question (six months) he received $835,000 as "loans" to finance various non-existent ventures. The district judge commented: "The Bankrupt, John Milton Addison, was a promoter on a large scale with almost magnetic powers in presenting his promotion schemes and by which means he collected immense sums of money. An unusual feature of his schemes for him and his several associates was to so impress the lenders of money that there was a fortune of untold millions involved and that they would become with him joint owners by reason of the loan, *but they must tell no one of that promise which he was making them.*" (Emphasis added.) Addison held out attractive lures. For example, he purported to own patent rights to a device, the Benson Upgrader, which at a total investment cost of $65,000 would produce profits of $86,000 a day and, by upgrading low-grade uranium, would replace a 13 million dollar uranium mill. He represented that he and his associates owned a uranium mine containing 2½ million dollars of uranium and that they controlled 20,000 acres in Colorado, rich in oil and gas, containing vast nickel deposits and timber reserves. He had plans under way to build a magnificent

hotel in Colorado where the lenders could own their own luxury suites. According to Addison, the Clint Murchison family was backing him and Merrill, Lynch, Pierce, Fenner and Beane had offered to purchase 49 per cent of his interests for 18 million dollars.

Addison's activities were conducted in a carefully planned and well-organized manner, with the assistance of a large number of associates.[3] Addison or his associates would meet with prospective investors and represent to them that Addison was engaged in speculative but highly profitable businesses. They suggested that if these people were to "lend" money to Addison's enterprises, they would be assured of getting back the amount of the "loans" and moreover would acquire a part interest in the enterprises, from which they could expect to receive handsome profits. The court below found as a fact that all of the representations made by Addison and his associates to induce these loans were false. Additionally we note, as did the court below, that Addison was convicted by a jury of using the mails to defraud as part of this scheme. See *Addison v. United States*, 5 Cir. 1963, 317 F. 2d 808, cert. denied, 376 U.S. 905, 84 S.Ct. 658, 11 L.Ed. 2d 605 reh. denied, 376 U.S. 966, 84 S.Ct. 1121, 11 L.Ed. 2d 984. Originally, these "loans" were "secured" by promissory notes, but on the complaint of the Securities and Exchange Commission, Addison was enjoined from issuing such notes in violation of the Securities and Exchange Act. *S.E.C. v. Addison*, N.D. Tex. 1961, 194 F. Supp. 709. Thereafter the loans had behind them Addison's oral promises.

[3] For a full discussion of Addison's operations, see *Securities and Exchange Commission v. Addison*, N.D. Tex. 1961, 194 F. Supp. 709, 714-721.

The record does not indicate exactly how many of these "loans" were made, or the total amount, but it is clear that the activity continued over many years and that the total sum was substantial. It is also clear from the record that Addison treated the funds provided by these loans as belonging to him and to his associates without any restriction. They constituted the sole source of income for Addison and his associates, and Addison lived lavishly on these funds. Most of the "lenders" are claimants in the bankruptcy proceeding.

The trial court held on this record that "the Bankrupt was a borrower of money which he promised to return". Accepting the findings of fact as supported by the record, we conclude that the Bankrupt was a *purported* borrower of money which he *falsely* promised to return. The transactions here were not loans at all, but a fraud to acquire money from innocent third parties.[4]

II.

The issue before us in this case may be stated as follows: When an individual secures money from many third parties by false representations, and when such funds constitute his sole source of support for several years, do these sums constitute taxable income, under section 61 of the Internal Revenue Code, notwithstanding the fact that the transactions are in the form of loans?

[4] Compare *Cohen v. United States*, 9 Cir. 1961, 297 F. 2d 76, in which transactions purported by the taxpayer to be loans were considered to be income by the court in a prosecution for tax evasion.

The proper labeling for tax purposes of various kinds of ill-gotten gains has long been a vexing question for the federal courts. In dealing with it, we keep in mind the admonition that in enacting what is now section 61 of the tax code, Congress meant "to use the full measure of its taxing power" under the Sixteenth Amendment. *Helvering v. Clifford*, 309 U.S. 331, 334, 60 S.Ct. 554, 84 L.Ed. 788. The Supreme Court, after many years of hesitation, has now firmly concluded that the *economic benefit* accruing to the taxpayer is the controlling factor in determining whether a gain is "income". *Rutkin v. United States*, 343 U.S. 130, 72 S.Ct. 571, 96 L.Ed. 833; *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 75 S.Ct. 473, 99 L.Ed. 483; *James v. United States*, 366 U.S. 213, 81 S.Ct. 1052, 6 L.Ed. 2d 246. A loan does not in itself constitute income to the borrower, because whatever temporary economic benefit he derives from the use of the funds is offset by the corresponding obligation to repay them. See *James v. United States*, *supra* at 219. Where the loans are obtained by fraud, and where it is apparent that the recipient recognizes no obligation to repay, the transaction becomes a "wrongful appropriation and comes within the broad sweep of 'gross income' " *Ibid.*

We perceive no qualitative difference with regard to taxability between the gains of an extortionist, held taxable in *Rutkin*, those of an embezzler, held taxable in *James*, and those derived by a confidence man like Addison. The extortionist uses coercion, the embezzler stealth, and the confidence man false promises. All are legally under an obligation to repay their ill-gotten gains. All are guilty of

crimes under the laws of the various states. As the Court said in *Rutkin:*

> An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. Burnet v. Wells, 289 U.S. 670, 678; Corliss v. Bowers, 281 U.S. 376, 378. That occurs when cash, as here, is delivered by its owner to the taxpayer in a manner which allows the recipient freedom to dispose of it at will, even though it may have been obtained by fraud and his freedom to use it may be assailable by someone with a better title to it. 343 U.S. at 137.

While it is true that the lenders in this case would appear to have a claim against Addison for repayment of their loan, this is not relevant to the question of their taxability to Addison.[5] Were we to hold otherwise, confidence men could avoid the tax consequences of their transactions by merely adding a false promise to repay to their other representations. Such a distinction between fraudulently obtained "loans" and fraudulently obtained outright grants is not tenable here.

The judgment below is REVERSED and the case REMANDED for further proceedings not inconsistent with this opinion.

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[5] The Referee in Bankruptcy and the district court below apparently considered it significant that the dispute here involves a contest between the United States and the defrauded lenders, who are the claimants in the Bankruptcy proceeding. While we are not without sympathy for these victims of Addison's schemes, we do not perceive the relevance of the procedural posture of the case in this respect. It is for Congress, and not the Courts, to determine priorities in both taxation and Bankruptcy. Since Congress has decided that income shall be taxable, and that a properly obtained lien for taxes shall have first priority in Bankruptcy, it is their decision and not ours that the United States shall take all and the other claimants nothing.

APPENDIX B-1

United States Court of Appeals

For the Fifth Circuit

October Term, 1966

No. 23923

D. C. Docket No. 4781—Bankruptcy

UNITED STATES OF AMERICA,

Appellant,

versus

WILLIAM J. ROCHELLE, JR., Trustee in Bankruptcy for JOHN MILTON ADDISON, Bankrupt,

Appellee.

Appeal from the United States District Court for the Northern District of Texas.

Before RIVES, WISDOM and GOLDBERG, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed, and that this cause be, and the same is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court.

October 20, 1967

Issued as Mandate: Nov. 13, 1967

APPENDIX C

Opinion Of The District Court

Honorable Elmore Whitehurst, Referee in Bankruptcy, certifies to the Court the proceedings in the above designated matter in which the United States of America filed a petition for review of an order entered on March 7, 1966, disallowing the claim of the United States for internal revenue taxes.

In presenting the facts upon which the certificate was based we consult freely the findings of fact by the Referee and also with reference to the petition of the United States asking such review.

The Bankrupt, John Milton Addison, was a promoter on a large scale with almost magnetic powers in presenting his promotion schemes and my which means he collected immense sums of money. An unusual feature of his scheme for him and his several associates was to go impress the lenders of money that there was a fortune of untold millions involved and that they would become with him joint owners by reason of the loan, but they must tell no one of that promise which he was making them.

We take the following findings of fact from the Referee:

> "John Milton Addison, the uranium promoter, was on July 7, 1960, adjudicated a bankrupt upon an involuntary petition filed against him in this court on February 23, 1960. William J. Rochelle, Jr., was duly elected Trustee of the estate at the first meeting of creditors on August 23, 1960, and has continued to serve in that capacity since that date.

"On July 2, 1959, the Secretary of the Treasury through his delegate terminated the tax year of Addison pursuant to Section 6851 of the Internal Revenue Code of 1954 (26 U.S.C., 1958 Ed., Section 6851) and assessed a tax liability for the period from January 1, 1959, through June 30, 1959, in the amount of $124,485.24.

"The checks and money orders in the possession of Braniff Airways, Inc., totaled $146,625.00 and consisted of $125,700.00 in cashier's checks, bank money orders and American Express money orders, and $20,925.00 in personal checks payable to John Milton Addison.

"These checks on July 10, 1959, were placed in the custody of the Marshal of the United States District Court for the Northern District of Texas. Thereafter, on July 19, the District Court ordered these checks and money orders delivered to the Receiver in Bankruptcy. On August 9, 1960, the District Court amended its order to provide that the delivery of the checks and money orders to the Receiver would be subject to the rights of the United States, if any, which it may have acquired by the levy on July 3, 1959, on Braniff Airways, Inc., for the alleged tax liability of John Milton Addison in the sum of $125,076.03, plus interest and penalties according to law.

"The advances received by Addison during the year 1959 amounted at least to the sum of $833,000.00.

"It is the position of the Government that these moneys obtained from third persons are the proceeds from a swindling operation and are therefore taxable. It is the position of the Trustee that the moneys were loans to the Bankrupt and are therefore not taxable.

"The Bankrupt consistently, uniformly and unequivocally promised to repay the funds with interest which he received during the period beginning in 1955 and continuing to about July 7, 1960, the date of his adjudication as a bankrupt. During the years 1955, 1956,

1957, 1958, and most of the year 1959, the Bankrupt issued written promissory notes payable to the lenders. Upon complaint of the Securities and Exchange Commission that these promissory notes were securities and were being issued in violation of the Securities Act, the Bankrupt during the year 1959 ceased issuing notes for money advanced to him and thereafter orally contracted to repay all amounts advanced to him with interest.

"In order to induce the lenders to let him have the money, the Bankrupt, either in person or by and through his associates, made false and fraudulent misrepresentations of fact, among which are the following:

"A. That Merrill Lynch, Pierce, Fenner & Bean had offered to purchase 49% of his money interest for the sum of 18 Million Dollars.

"B. That the Bankrupt owned patent rights to the Benson Upgrader which at a cost of $65,000.00 would replace a uranium mill costing 13 Million Dollars, and that such mill would earn a net profit of $86,000.00 a day.

"C. That the Bankrupt owned a uranium mine containing 2½ Million Dollars worth of uranium.

"D. That a nephew of Clint Murchison, a well known financial figure was backing the Bankrupt's uranium ventures.

"E. That J. C. Tonn, an associate of the Bankrupt, was a chief chemist with long experience with an oil company.

"F. That the Bankrupt or companies controlled by him had mineral rights to approximately 20,000 acres of land in the Arapahoe National Forest near Granby, Colorado, containing vast nickel deposits.

"G. That the Bankrupt or companies owned or controlled by him had rights to timber standing on

20,000 acres in the Arapahoe National Forest near Granby, Colorado.

"H. That the Bankrupt was going to build a luxury hotel near Golden, Colorado, and that he had made arrangements to bring water to the location on the top of Tabletop Mountain and that the Murchison family of Texas was financing this venture.

"The third parties who advanced money to the Bankrupt believed that they were making loans to him and would receive repayment of the money loaned to him with substantial increments thereto. They would not have let him have the money in the absence of such promises.

"There was no restriction upon the use of the money obtained by the Bankrupt as a result of the foregoing described transactions.

"There was, in every transaction wherein the Bankrupt obtained any money sought to be taxed herein as income, a consensual recognition between the Bankrupt and lender, express in some instances and implied in the remaining instances, of the obligation of the Bankrupt to repay to the lender the money advanced to him."

The Government in its petition of review recites the following:

"That on July 3, 1959, the District Director for the Internal Revenue Service served a Notice of Levy with respect to said tax liability on Braniff Airways, Inc., which at that time was holding checks and money orders for the taxpayer, John Milton Addison, in the sum of $146,625, which sum consisted of $125,700 in cashiers' checks, bank money orders and American Express money orders, and $20,925 in personal checks payable to John Milton Addison. These checks and money orders were placed in the custody of the Mar-

shal of the United States District Court for the Northern District of Texas."

It might clarify matters for one reading the record for the first time that the Bankrupt left on board a plane of Braniff Airways a portfolio or brief case containing more than a hundred thousand dollars in casheir's checks and securities. Braniff was holding it for him and the Government seized it and it was eventually placed in the custody of the Receiver in Bankruptcy.

Addison not infrequently carried vast sums of money on his person or in this manner. On one occasion he exhibited a large batch of bills, all of which were $1,000.00 each. He likewise spent very freely, having accommodations in a hotel at San Antonio to entertain his guests and prospective lenders, sums that would reach into hundreds of dollars.

The Bankrupt was tried before this Court on a criminal charge which occupied something better than four weeks. We remember very distinctly the type of evidence that was offered which in accordance with our well known practice we feel at liberty to refer to and use in reaching our conclusions.

A judge may assume judicial knowledge of facts which he has learned through former litigation in the same jurisdiction; and he may take judicial cognizance of what he himself has done as judge. *(Anderson ex rel Poe v. Gladden,* 288 P. 2d 823; *Carmack v. Fidelity Bankers Trust Co.,* 177 S.W. 2d 351; *American Nat. Bank v. Bradford,* 188 S.W. 2d 971) The Carmack (supra) case is authority for the proposition that the Court may take judicial knowledge of facts

which it has learned on an earlier hearing of the same case and what it has done at a previous hearing of that case.

Based upon the findings of the Referee which we regard as entirely correct and upon our own memory and recollection of the voluminous record that was made at his trial, it is the finding and opinion of the Court that the Bankrupt was a borrower of money which he promised to return.

As stated, the Government takes the position that the money collected by the Bankrupt was not the outcome of a loan but of an act of swindling the people and that the money so collected is subject to taxation when treated on that basis.

The question therefore before the Court is that raised by the Government in its petition for review: Was the money collected from the numerous lenders of small and large sums borrowed money in the usual acceptation of the word "loan," or was it the product of a swindling game which the said Bankrupt operated and that he thereby became the owner of the money by so procuring it?

The Court's position is that the Referee in his findings must be sustained. *That which a man borrows he does not earn.*

We feel that this position is so well established that it is hardly needful to cite extensive authority. *James v. United States,* 366 U.S. 213, is to the following effect:

> "When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, he has received income . . . *This standard . . . excludes loans.*" (Emphasis ours)

Reasoning in line with the above opinion Judge Sibley in the case of *McKnight v. Commissioner*, 127 F. 2d, held:

> "It must be conceded that no gain is realized by borrowing, because of the offsetting indebtedness. This would be true even though at the time there was no intention to repay."

Moreover, a man's earnings are universally a part of his income. The Bankrupt did not earn this money.

Section 61 of the U. S. Internal Revenue Code gives a general definition:

> ". . . (G)ross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, and similar items;
>
> (2) Gross income derived from business;
>
> (3) Gains derived from dealings in property, etc."

Turning for the moment to the testimony of those who advanced money, we envision a young woman dressed in black, but yet in almost a vivacious attitude, who took the witness stand and said, "Yes, I did lend this young John Milton Addison $15,000.00 and if he wants $15,000.00 more I will lend this to him also. The moment that I first beheld him I knew he was an honest young man and I can trust him with this money."

When asked if she expected any proceeds or return from the money except her money she replied that she most as-

suredly did not and the only profit she expected was the interest on the loan.

Many notes were given, but when the Securities and Exchange Commission started investigating the case it seems in some instances after that the loans were made an a verbal transaction, but the vast amount of the proceedings were had along the same lines as the young lady in black, also that of a certain minister of the Gospel who lived in a distant state. He pledged all of his money and then after he had pledged his individual means he pledged a fund that belonged to his church, fully believing and hoping that he would participate in the great fortune that the uranium upgrader and other enterprises in which the Bankrupt was engaged would help him to carry out his most favorite projects in advancing his cause and his congregation.

As further inducements and to inspire the confidence of those from whom he would procure loans, he publicized and made known to the public that he owned a vast lease in a portion of the Rocky Mountain region in which there was a rich deposit of nickel and on which there was valuable timber and that in this lease he was associated with the very wealthy family of Murchisons whose financial projects extended over the whole United States. When the fact was developed the record showed that no Murchison had any knowledge of the matter whatever.

To keep up enthusiasm of lady investors no doubt, he envisioned a project of building a great hotel in the vicinity of

Denver, that there would be a magnificent golf course in connection with this hotel, many fine reception rooms and that when it was accepted everyone who had loaned him money would be his invited guest. Two of the lady witnesses admitted that they had bought expensive gowns to wear to this reception on the completion of this vast enterprise of entertainment.

It is difficult to believe that such large sums of money could be collected by the Bankrupt and it was more amazing to see that the lenders to a large degree would seek to protect him and state they were not expecting anything out of it except their interest and that it was a loan pure and simple.

The judgment of the Court is that the decision and findings by the Referee be sustained and that the Trustee recover possession of the Bankrupt estate.

/s/ T. W. Davidson
United States Senior District Judge